

**The Internal Revenue Service Could Reduce  
the Burden Placed on Business Taxpayers  
When Resolving Account Overpayments**

**August 1999**

**Reference Number: 093402**



INSPECTOR GENERAL  
for TAX  
ADMINISTRATION

DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C. 20220

August 9, 1999

MEMORANDUM FOR COMMISSIONER ROSSOTTI

FROM:

  
Pamela J. Gardiner  
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – The Internal Revenue Service Could  
Reduce the Burden Placed on Business Taxpayers When  
Resolving Account Overpayments

This report presents the results of the subject audit that was conducted as part of our broader effort to identify opportunities to improve customer service and reduce burden for business taxpayers.

If a taxpayer files a tax return where payments on the Internal Revenue Service's (IRS) records are greater than those claimed by the taxpayer, the IRS computer will check for a tax period with a balance due for a similar amount. If a balance due is found, the computer will transfer the Federal Tax Deposit (FTD) overpayment to that tax period. In summary, this IRS automated process correctly transferred the majority of these misapplied FTD payments to the appropriate tax period. For Tax Year 1995 tax periods, this process prevented approximately 600,000 overpayment notices from being issued to taxpayers. However, the IRS could further reduce taxpayer burden and government costs by not requiring taxpayers to respond to overpayment notices if they prefer to have the computer automatically refund the payment.

The Chief Operations Officer responded that the notices have been rewritten and this should expedite responses from taxpayers. He stated that requiring a response and encouraging taxpayers to call rather than write would expedite refunds and reduce interest costs. The revised notices provide specific information on when taxpayers should expect a refund if they call, write, or do not respond. We concur with the planned actions. The Chief Operations Officer's comments have been incorporated into the report where appropriate and the full text of his response is presented as Appendix IV to this report.

Copies of this report are also being sent to the Internal Revenue Service managers who are affected by the report recommendations. Please call me at (202) 622-6510 if you

have any questions, or your staff may contact Maurice S. Moody, Associate Inspector General for Audit (Headquarters Operations & Exempt Organization Program) at (202) 622-8500.

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## **Executive Summary**

The Internal Revenue Service's (IRS) computer routines effectively corrected instances where taxpayers inadvertently submitted Federal Tax Deposit (FTD) payments to fully paid tax periods (which would have resulted in overpayments), rather than to the tax periods where they had owed money. These computer routines were over 90 percent accurate, for Tax Year 1995 tax periods, in determining where the overpayments should be transferred. Transferring these overpayments prevented approximately 600,000 notices from being mailed to taxpayers asking them to respond to resolve the payment problem.

The IRS pays interest to taxpayers on refunds held for more than 45 days after either the due date of the return, or the date the taxpayer files the return. The rate of interest the IRS must pay on refunds is based on the federal short-term interest rate and is recalculated quarterly.

To resolve overpayments on accounts, the IRS sends notices to taxpayers who file Employer's Quarterly Federal Tax Returns (Form 941) rather than refunding the payments immediately. The notices require taxpayers to advise the IRS within 30 days what to do with the overpayments. If the taxpayers do not respond, the computer will automatically refund the overpayments to them 15 weeks after the notices are issued. However, the IRS could further reduce taxpayer burden and government costs by considering not requiring taxpayers to respond to overpayment notices if they prefer to have the computer automatically refund the payment.

This review was conducted as part of our broader effort to identify opportunities to improve customer service and reduce burden for the business taxpayer. As part of the Office of Audit's Business Taxpayer Audit Strategy, we evaluated the IRS' process for resolving instances where taxpayers submit FTD payments to the wrong tax periods.

## **Results**

### **The IRS Should Not Require Taxpayers to Respond to Overpayment Notices If They Prefer to Have the Computer Automatically Refund the Payment**

If taxpayers do not respond to overpayment notices, the IRS computer system will issue the refunds in 15 weeks. The computer automatically released and refunded 80 percent of the overpayments in 15 weeks because taxpayers did not respond to the notices. The

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remaining 20 percent of taxpayers who were due a refund responded to the notices and received their refunds in less than 15 weeks. If these taxpayers had not been required to respond and the computer had automatically released the refunds, the IRS would have paid \$490,000 in additional interest and saved approximately \$255,000 in processing costs.

### **Summary of Recommendation**

To significantly reduce taxpayer burden, we believe the IRS should consider rewording notices to require a response only when the payments should be transferred to a different tax period rather than refunded, and to inform the taxpayer that the refund will be released in 15 weeks.

Management's Response: The Chief Operations Officer responded that the notices have been rewritten and this should expedite responses from taxpayers as well as reduce interest costs. The revised notices also provide specific information on when taxpayers should expect a refund if they call, write, or do not respond. The Chief Operations Officer stated that requiring a response and encouraging taxpayers to call rather than write would expedite refunds and reduce interest costs. He believes the additional burden would be fairly insignificant when weighed against the additional interest.

The Chief Operations Officer's comments are included in the body of this report, where appropriate, and the full text of his comments is included as Appendix IV.

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## **Preface**

*We initiated a series of national reviews for the Business Taxpayer Audit Strategy.*

This review of the Internal Revenue Service's (IRS) process for resolving instances where taxpayers submit Federal Tax Deposit (FTD) payments to the wrong tax periods was conducted as part of our Fiscal Year 1997 Business Taxpayer Audit Strategy. Under the strategy, we initiated a series of national reviews that were designed to identify opportunities to improve customer service and reduce burden for the business taxpayer. Collectively, this series of reviews addressed the major points of contact that a business taxpayer could have with IRS, such as establishing a new business, making tax deposits and filing returns, and responding to notices. We evaluated the IRS' current processes from the perspective of how the business taxpayer might view them.

We discussed the reviews included in the strategy with executive management and obtained their input on objectives and potential outcomes, as well as their commitment to take appropriate actions. We also worked closely with all levels of IRS management to determine the significance and scope of the burden on the business taxpayer and the inefficiencies in existing practices for providing quality customer service.

## **Objective and Scope**

*We evaluated the process for resolving payments submitted to the wrong tax periods.*

We conducted this review to evaluate the IRS' process for resolving instances where taxpayers submit FTD payments to the wrong tax periods. We conducted the review during the period April 1997 through September 1998. The audit was conducted in accordance with *Government Auditing Standards*.

We analyzed Employer's Quarterly Federal Tax Return (Form 941) tax periods and reviewed accounts with misapplied FTD payments to determine if the IRS could cost-effectively resolve them to reduce the number of

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erroneous or unnecessary notices, reduce taxpayer burden, and reduce government costs. We intentionally analyzed an older Tax Year (1995) to allow the time necessary for the accounts to be resolved.

Details of our audit objective, scope, and methodology are presented in Appendix I. Major contributors to this report are listed in Appendix II.

### Background

A taxpayer may file a Form 941 claiming payments that do not match those on the IRS' records. When the payments do not match, the IRS has processes to identify and resolve payments that appear to be submitted to the wrong tax period to avoid sending erroneous or unnecessary notices to taxpayers. For example, if a taxpayer submits an FTD payment for an incorrect tax period, the computer will check for a tax period with a balance due for a similar amount. If a balance due is found, the computer will transfer the overpayment to that tax period.

The IRS pays interest to taxpayers on refunds held for more than 45 days after either the due date of the return, or the date the taxpayer files the return. The rate of interest the IRS must pay on refunds is based on the federal short-term interest rate and is recalculated quarterly.

*IRS processes help to resolve misapplied payments before notices are generated or mailed.*

The FTD rollover/rollback process identifies payments applied to wrong tax periods and moves them through computer routines before notices are generated. Notices are generated for accounts with misapplied payments that are not resolved through the FTD rollover/rollback process.

Before they are sent to the taxpayers, these notices may be selected by the Notice Review Processing System for manual review. Under this process, employees in the service centers' Output Review functions review the notices and taxpayers' accounts. They determine if each notice should be voided, retyped, or mailed. They also



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make necessary adjustments to correct taxpayers' accounts, including transferring FTD payments to the correct tax period. By correcting accounts and notices, Output Review employees help prevent erroneous or unnecessary notices from being mailed to taxpayers.

### **Results**

*One IRS process prevented approximately 600,000 notices asking taxpayers to respond to resolve payment problems.*

The FTD rollover/rollback process identified and moved over 700,000 misapplied FTD payments, for Tax Year 1995, with an accuracy rate exceeding 90 percent. This prevented approximately 600,000 notices from being sent to taxpayers asking them to respond to resolve payment problems. The Output Review function's manual review of computer selected notices also prevented unnecessary notices from being sent to taxpayers.

The IRS sends notices to taxpayers to resolve the overpayments on their accounts, rather than refunding the overpayments immediately. The notices require taxpayers to respond within 30 days with information on what to do with the overpayment amounts. However, if the taxpayers do not respond, the overpayments are automatically refunded to the taxpayers 15 weeks after the notices are issued. The 15-week criterion allows the IRS the time necessary to process correspondence and make adjustments to taxpayers' accounts.

Customer Service management could further reduce taxpayer burden and government costs by considering not requiring taxpayers to respond to overpayment notices if they prefer to have the computer automatically refund the payment.

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### The IRS Should Not Require Taxpayers to Respond to Overpayment Notices If They Prefer to Have the Computer Automatically Refund the Payment

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*Taxpayers are required to respond to overpayment notices in 30 days.*

The IRS requires taxpayers who receive overpayment notices to respond within 30 days. Currently, the notices do not indicate that the overpayment will be automatically refunded in 15 weeks after the notice is issued if the taxpayer does not respond.

*Approximately 80 percent of taxpayers due a refund did not respond to the notices.*

Our analysis indicated that 236,657 of 293,131 (approximately 80 percent) of the taxpayers due refunds did not respond to the notices, and the overpayments were refunded in 15 weeks. Computer records indicate that about 46,660 taxpayers contacted the IRS to request their refunds during the 15-week period.

*Automatically issuing taxpayers their refunds would save IRS processing costs and reduce taxpayers' burden.*

If taxpayers did not have to respond when they preferred to have the computer automatically refund the payments, it would save business taxpayers the time required to respond. It would also save the IRS the salary costs of having employees handle the written responses or the phone calls. The IRS would save approximately \$255,000<sup>1</sup> in processing costs if refunds were automatically issued rather than manually issued. Also, requiring business taxpayers to respond for a scheduled refund is not good customer service.

Providing this option to the business taxpayer would save IRS the processing costs and the business taxpayer the time required to respond. The only costs to the IRS would be about \$490,000 in additional interest if the 46,660 taxpayers had not responded to the notice and the refunds were automatically issued in 15 weeks.

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<sup>1</sup> Computed using data from Document 6745, *Cost Estimate Reference*, FY 96, and assuming Customer Service worked the responses. Costs included salary, overhead, benefits, and telecommunication costs required to manually issue the 46,660 refunds.

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### **Recommendation**

1. The IRS should consider rewording notices to require a response only when credits should be moved rather than refunded, and to inform taxpayers that the refund will be released in 15 weeks. The notice should also instruct taxpayers to respond if they would like the refund sooner.

Management's Response: IRS is revising the notices to encourage the taxpayer to call rather than write. The notices will inform taxpayers that if they call requesting that their overpayments be refunded, the IRS can issue the refunds in three to four weeks. However, if the taxpayers write requesting that overpayments be refunded, IRS will take six to eight weeks to issue the refunds. The notices also advise taxpayers that if they do not respond, the refund will be delayed up to four months. The Chief Operations Officer stated that requiring a response and encouraging taxpayers to call rather than write would expedite refunds and reduce interest costs. He stated that the increase in the business taxpayers' burden would be fairly insignificant when weighed against the additional interest it would cost the IRS.

Office of Audit Comment: We concur with the actions planned by the Chief Operations Officer.

### **Conclusion**

The IRS plan of revising the notices to inform taxpayers of when they can expect their refunds based on how and if they respond to the notices allows the business taxpayers the knowledge to make an informed decision.

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### **Appendix I**

#### **Detailed Objective, Scope and Methodology**

We conducted this review as part of the Office of Audit's Fiscal Year 1997 Business Taxpayer Audit Strategy to evaluate misapplied Federal Tax Deposit (FTD) payments and their effect on notices for the business taxpayer. We determined if there were additional methods to prevent or resolve Employer's Quarterly Federal Tax Return (Form 941) notices caused by misapplied FTD payments. We reviewed accounts with misapplied FTDs to determine if the Internal Revenue Service (IRS) could cost-effectively resolve them to reduce the number of erroneous or unnecessary notices, reduce taxpayer burden, and reduce government costs.

- I. We performed a computer analysis on Tax Year 1995 Form 941 tax modules to determine the effect of the FTD rollover/rollback process.
  - A. We evaluated Program Requirement Packages for the FTD rollover/rollback process, and discussed the characteristics of these transactions to determine the criteria to use to identify FTD payments that had been rolled over or back.
  - B. We obtained a computer extract of all 709,419 1995 FTD payments to determine the number of FTD payments that were rolled over or rolled back into the modules by the process, the number of payments that were subsequently reversed, and the number of affected tax modules.
- II. We identified all 820,608 Tax Year 1995 Form 941 modules that were overpaid when the return posted and had payments on the account that exceeded those claimed on the return. Of those, we evaluated the 496,142 accounts where notices would have been issued to taxpayers to resolve the overpayments. We determined the effect on accounts if refunds were issued sooner when taxpayers do not respond. We also determined the effect on accounts if taxpayers did not need to respond when they are entitled to a refund.
  - A. We obtained a computer extract of all 236,657 modules with a refund or offset computer generated 15 weeks after the return posted to the account, and an additional 56,474 modules where the refunds were manually released by IRS employees. We determined the potential interest savings if the computer-generated refund had been issued after 12 weeks.
  - B. We obtained a computer extract of all 203,011 modules with overpayments resolved with transactions other than refunds or offsets. We calculated the number of weeks it took to resolve the overpayments. We identified accounts that would have been adversely affected and determined the impact on these

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accounts if the computer-generated refunds had been issued three weeks sooner.

- C. We obtained a computer extract that identified all 56,474 modules with a refund released by employees within 15 weeks of the return posting, of which 46,660 refunds were apparently released because of taxpayer responses to the notices. The remaining 9,814 did not meet the criteria of one adjustment action to release the refund with no other transactions in the adjustment cycle.
  - 1. We determined the number of modules with refunds released by employees who work taxpayer responses.
  - 2. We calculated the number of weeks from the return posting until the refund was released.
  - 3. We calculated the potential cost savings for the IRS and the additional interest the government would pay if these taxpayers did not respond.

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**Appendix II**

**Major Contributors to This Report**

Stephen Mullins, Regional Inspector General for Audit  
Mary Baker, Deputy Regional Inspector General for Audit  
Gail Yorgason, Audit Manager  
Carola Gaylord, Auditor  
Aaron Foote, Auditor  
Mike Garcia, Auditor  
Karl Zenft, Auditor

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**Appendix III**

**Report Distribution List**

National Director for Legislative Affairs CL:LA  
Assistant Commissioner (Program Evaluation and Risk Analysis) M:OP  
Office of Management Controls M:CFO:A:M  
Chief Operations Officer OP  
Assistant Commissioner (Customer Service) OP:C  
National Director, Customer Service Compliance, Accounts and Quality OP:C:A  
Audit Liaisons:  
    Chief Operations Officer OP  
    Assistant Commissioner (Customer Service) OP:C

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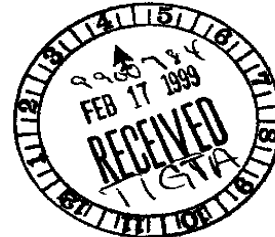
**Appendix IV**

**Management's Response to the Draft Report**



CHIEF OPERATIONS OFFICER

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224  
February 16, 1999



MEMORANDUM FOR ACTING TREASURY INSPECTOR GENERAL FOR  
TAX ADMINISTRATION

FROM:

*John M. Dalrymple*  
John M. Dalrymple  
Chief Operations Officer

SUBJECT:

Draft Internal Audit (IA) Report - Enhancing Notices Concerning  
Federal Tax Deposit Payments

Thank you for allowing us to comment on the draft report referenced above. The report makes two recommendations concerning this subject. Generally we agree with the findings and recommendations in the report with the exception of #2. Each response is addressed individually below.

**RECOMMENDATION #1**

Reduce the number of weeks overpayments are held from 15 to 12 weeks or less.

**ASSESSMENT OF CAUSE(S)**

Currently, automatic release of refunds to taxpayers occurs 15 cycles after issuance of a master file notice (CP 267 or 268). In 1995, 91 percent of the accounts involved were rectified within 12 weeks. The remaining 9 percent were either rectified after 12 weeks or were automatically released. IA figures state approximately \$685,000 in interest would have been saved if the overpayments had been released after the twelfth week.

**CORRECTIVE ACTIONS**

No corrective action will be taken **at this time**. Currently, an outside vendor is assisting the Internal Revenue Service (IRS) in rewriting master file notices. CPs 267 and 268 are included in this endeavor. We believe the rewording of the notices will expedite responses from taxpayers and result in fewer accounts reaching the 15 week release timeframe. (See Corrective Action response to Recommendation 2.) Approximately 1 year after the implementation of the revised CPs 267 and 268, we will obtain data to determine if the revised notices have resulted in a decrease in the percentage of CPs 267 and 268 which reached the automatic 15 week release.

The most important factor to consider in reducing the number of weeks from 15 to 12, or less, is the number of erroneous refunds which would result. The report verifies approximately 16,000 "inappropriate refunds" would have been issued if the timeframe would have been reduced to 12 weeks. These "inappropriate refunds" are non-rebate erroneous refunds. These refunds cause IRS to unnecessarily expend resources to try



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to recover them, and are extremely difficult to recover if the taxpayer does not voluntarily resubmit the amount of the refund. We can no longer administratively recover these refunds, so in some cases legal action is the next step. Non-rebate erroneous refunds result in accounts being frozen, individually monitored, and the possibility they will ultimately be placed in "currently not collectible status." Non-rebate erroneous refunds result in additional taxpayer burden when the IRS contacts them in an effort to recover the refund.

Current processing timeframes make the 15 week delay preferable to 12 weeks or less. The taxpayer is given 30 days to respond (slightly over 4 weeks) and the IRS currently needs about another 9 weeks to process correspondence and post adjustments. Therefore, to implement a timeframe of 12 weeks or less would not provide the necessary time to resolve these cases.

### **IMPLEMENTATION DATE**

To be determined after data extract is performed.

### **RESPONSIBLE OFFICIAL(S)**

Assistant Commissioner (Customer Service) OP:C

National Director, Compliance and Accounts Division OP:C:A

### **RECOMMENDATION #2**

Consider rewording notices to only require a response when credits should be moved rather than refunded and to inform the taxpayer the refund will be released in 15 weeks (or less if the time refunds are held is reduced). The notice should also instruct the taxpayer to respond if they would like the refund sooner.

### **ASSESSMENT OF CAUSE(S)**

Approximately 80 percent of the taxpayers did not respond to the notice within the 15 week timeframe. IRS currently requires all taxpayers to respond to CPs 267 and 268. Taxpayer burden is increased when the taxpayer is required to respond to the notice.

### **CORRECTIVE ACTIONS**

An outside vendor is currently assisting the IRS in rewriting CPs 267 and 268. In the revised notices, the taxpayer will be encouraged to call rather than write. To encourage calling, the taxpayer will be advised that a refund will be issued in 3-4 weeks by calling, while writing will result in the refund being issued in 6-8 weeks. (By calling, the refund can be released immediately. Writing requires time for the mail to reach the centers and then be batched with other correspondence to be processed and responded to within 45 days of receipt.) The notice will advise the taxpayer to call "as soon as possible, but no later than 30 days." It will also advise the taxpayer if no response is received, the refund will be delayed up to 4 months.

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We do not agree with the recommendation to only require the taxpayer to respond if credits should be moved rather than refunded. We believe the increase in taxpayer burden to a business taxpayer to respond to the notice is fairly insignificant when weighed against the large amount of additional interest which would be required to be paid to the taxpayer if the refund would not be issued for up to 11 additional weeks (15 week release minus 4 week release if the taxpayer calls immediately; or 8 weeks if the automatic release was reduced to 12 weeks). The report states this would save IRS approximately \$255,000 in processing costs and that \$685,000 in interest would have been saved by decreasing the automatic release from 15 to 12 weeks - a 3 week difference. Using those figures, an 11 week delay would cost IRS approximately \$3 million since interest is compounded daily. The vast majority of taxpayers want their refund as soon as possible. By requiring a response, this will expedite the refund to the taxpayer and also reduce the payment of interest by the government.

### **IMPLEMENTATION DATE**

The rewrite of the CP notices is ongoing. It is estimated the revised notices will be ready for release to taxpayers in January 2000.

### **RESPONSIBLE OFFICIAL(S)**

National Director, Compliance and Accounts Division OP:C:A  
Assistant Commissioner (Customer Service) OP:C

Should your staff require additional information, they may contact William Wayland at 606-292-7861.

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### **Appendix V**

#### **Office of Audit Comments to Management's Response**

Based on information provided in the response from the Chief Operations Officer to our draft report (see Appendix IV), we deleted the recommendation that the Internal Revenue Service should consider changing the time period that overpayments are held before refunding (see Management's Response to Recommendation 1 on pages 10 and 11). We also concur with the actions planned by the Chief Operations Officer to address Recommendation 2 from the draft report (see Office of Audit Comment on page 5).